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C O N F I D E N T I A L SECTION 01 OF 04 ROME 005049

SIPDIS

TREASURY FOR CAROL CARNES

E.O. 12958: DECL: 10/17/2012

TAGS: [ECON](#) [EFIN](#) [PGOV](#) [EFIN](#) [PGOV](#) [EFIN](#) [PGOV](#) [EUN](#)

SUBJECT: THE 2003 BUDGET (PART I): A TIGHTROPE WALK

CLASSIFIED BY: ECONOMIC MINISTER COUNSELOR SCOTT KILNER FOR REASONS 1.5
(B) AND (D)

1. (U) THIS IS THE FIRST OF A TWO-PART SERIES ON THE ITALIAN BUDGET.

2. (C) SUMMARY: A DIVIDED ITALIAN CABINET, AFTER AN ALL-NIGHT DEBATE, HAS AGREED UPON AND SENT TO PARLIAMENT THE HIGHLY CONTROVERSIAL 2003 BUDGET. THE BERLUSCONI GOVERNMENT'S BUDGET IS AN ATTEMPT TO PROMOTE ECONOMIC GROWTH AND FULFILL CAMPAIGN PROMISES, WHILE CUTTING SPENDING WHEREVER POSSIBLE. THE RESULT IS A BUDGET DIVIDED BETWEEN TARGETED TAX CUTS AND INFRASTRUCTURE INVESTMENT ON ONE HAND AND SPENDING CUTS AND CAPS FOR MINISTRIES, REGIONAL AND MUNICIPAL GOVERNMENTS ON THE OTHER. SENIOR GOI OFFICIALS HAVE ASSURED US THAT DEFENSE MINISTRY CUTS WILL NOT MEAN CUTS IN PROCUREMENT FROM U.S. DEFENSE FIRMS. FINANCE MINISTER TREMONTI WAS THE MAIN ARCHITECT OF THE 2003 BUDGET AND WILL BE ITS KEY DEFENDER IN PARLIAMENT. IF THE BUDGET DEFICIT IS HIGHER THAN THE 1.5 PERCENT PREDICTED, WHICH MANY ECONOMISTS SAY IS LIKELY, THEN TREMONTI WILL NEED TO FIND ADDITIONAL RESOURCES OR FURTHER SPENDING CUTS. ON THIS TIGHTROPE, THE FINANCE MINISTER'S REPUTATION -- AND IN NO SMALL MEASURE THAT OF PRIME MINISTER BERLUSCONI -- LIES IN THE BALANCE.

3. (SBU) PARLIAMENT MUST PASS THE BUDGET BY THE END OF DECEMBER. THE CENTER-LEFT IN PARLIAMENT, INDUSTRIALISTS AND UNIONS ARE FINDING COMMON GROUND IN THEIR OPPOSITION TO THE
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BELT-TIGHTENING MEASURES PROPOSED BY THE GOVERNMENT. IN CONTRAST, SOME NATIONAL FIGURES ARGUE THAT THE GOVERNMENT SHOULD HAVE ENACTED PROMISED STRUCTURAL REFORMS BY NOW AND TRIMMED MORE FAT OFF THE BUDGET. THIS CABLE LOOKS AT THE BREWING BUDGET BATTLE, THE POTENTIAL WINNERS AND LOSERS, AND THE IMPLICATIONS FOR THE BERLUSCONI GOVERNMENT. (SEPTTEL WILL PROVIDE SPECIFIC DETAILS ON THE BUDGET.) END SUMMARY.

THE DRAFT 2003 BUDGET

4. (SBU) ON OCTOBER 2, THE GOI PRESENTED ITS 2003 BUDGET TO PARLIAMENT, TOTALING E619 BILLION (47.4 PERCENT OF GDP) IN SPENDING. THE PLAN INCLUDES E20 BILLION IN PLANNED SPENDING CUTS, PARTIALLY OFFSET BY TAX CUTS OF E7.5 BILLION TO ENCOURAGE ECONOMIC GROWTH. AMONG THE REVENUE GENERATING MEASURES ARE PLANNED SALES OF STATE ASSETS, WITH A POTENTIAL PAYOFF OF E4 BILLION, AS WELL AS A TAX AMNESTY, WHICH COULD RAISE AS MUCH AS E8 BILLION.

THE ARCHITECTS

5. (SBU) PRIME MINISTER BERLUSCONI AND FINANCE MINISTER TREMONTI AGREED ON THE DIFFICULT FRAMEWORK FOR THE BUDGET: CUT TAXES AND LAUNCH AN INFRASTRUCTURE INVESTMENT PROGRAM, AS PROMISED DURING THE 2001 CAMPAIGN; CUT SPENDING BUT WITHOUT ANGERING KEY CONSTITUENCIES; AND AVOID VIOLATING STABILITY PACT TARGETS.

6. (SBU) ACHIEVING A BALANCE BETWEEN THESE COMPETING AND
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OFTEN CONFLICTING GOALS PROVED CHALLENGING IN THE EXTREME. FINANCE MINISTER TREMONTI AND HIS ECONOMIC TEAM HAVE CHOSEN A PATH THAT COMBINES CUTTING AND CAPPING SPENDING, WHERE POSSIBLE, WITH TAX AMNESTIES TO BRING IN ONE-TIME REVENUES. FINANCE MINISTRY OFFICIALS ARE COUNTING ON A GLOBAL ECONOMIC RECOVERY IN LATE 2003 TO RAISE TAX REVENUES, BOLSTER THE PRICE OF STATE-OWNED ASSETS, AND ENCOURAGE INVESTMENT.

7. (C) COMMENT: WHILE TREMONTI WAS THE ARCHITECT OF THIS BUDGET, AND OF THE ENTIRE BERLUSCONI ECONOMIC PLAN, HE HAS SURROUNDED HIMSELF WITH A HAND-PICKED CADRE OF LIEUTENANTS, MANY OF WHOM REPLACED LONG-TIME SENIOR CIVIL SERVANTS. AMONG THE COTERIE ARE DOMENICO SINISCALCO, FINANCE MINISTRY DIRECTOR GENERAL (REPLACED MARIO DRAGHI, WHO HAD HELD THIS POSITION FOR NEARLY A DECADE); DEPUTY FINANCE MINISTER ANTONIO BALDASSARI; UNDER SECRETARIES VITO TANZI AND GIUSEPPE VEGAS; DIRECTOR GENERAL FOR ACCOUNTING VITTORIO GRILLI (THE

GOI EQUIVALENT OF THE OMB DIRECTOR) AND VINCENZO FORTUNATO,
CHIEF OF CABINET. THE SUCCESS OR FAILURE OF THE 2003 BUDGET
-- ECONOMICALLY AND POLITICALLY WILL REFLECT STRONGLY ON THIS
TEAM. END COMMENT

THE "LOSING SIDE"

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INFO	LOG-00	NP-00	AGRE-00	AID-00	CEA-01	CIAE-00	COME-00
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	IRM-00	SSO-00	STR-00	USIE-00	PMB-00	DSCC-00	PRM-00
	DRL-02	G-00	NFAT-00	SAS-00	/009W		

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P 170728Z OCT 02
FM AMEMBASSY ROME
TO SECSTATE WASHDC PRIORITY 6349
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NATO EU COLLECTIVE PRIORITY
AMCONSUL FLORENCE PRIORITY
AMCONSUL FRANKFURT PRIORITY
AMCONSUL MILAN PRIORITY
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18. (SBU) TAXPAYERS: ON TAX CUTS, THE BUDGET PROPOSES A REDUCTION IN PERSONAL INCOME TAX THAT WILL BENEFIT LOW-INCOME FAMILIES. WHILE THIS MAY SATISFY SOME VOTERS, MOST ITALIANS WILL NOT BENEFIT. DURING THE 2001 CAMPAIGN, THEN-CANDIDATE BERLUSCONI PROMISED FUNDAMENTAL REFORM OF THE TAX SYSTEM, INCLUDING ELIMINATION OF THE COMPLEX NETWORK OF OVERLAPPING TAX LEVIES. TREMONTI HAS NOW DESIGNED A NEW STRUCTURE: A HIGHER MINIMUM INCOME BEFORE TAXES, AND TWO TAX BRACKETS -- 23 PERCENT BELOW E100,000 INCOME AND 33 PERCENT OVER THAT LEVEL. TOP TAX RATES FOR THE HIGHEST INCOME GROUP WOULD HAVE FALLEN FROM 42.5 PERCENT TO 33 PERCENT; FOR MIDDLE-INCOME GROUPS, FROM A MAXIMUM RATE OF 39 PERCENT TO 23 PERCENT. GLOBAL ECONOMIC CONDITIONS FORCED THE GOI TO POSTPONE THIS REFORM UNTIL 2003. NOW, IF APPROVED BY PARLIAMENT, THE NEW INCOME TAX RATES WILL NOT KICK IN BEFORE 2004 AT THE EARLIEST.

19. (C) THE MINISTRIES: THE 2003 BUDGET PROPOSES A 10 PERCENT SPENDING CUT IN DISCRETIONARY FUNDS FOR ALL GOVERNMENT MINISTRIES. FINANCE DEPUTY SECRETARY BALDASSARI TOLD US THAT THE GOVERNMENT HOPES TO ACHIEVE SUBSTANTIAL SAVINGS POSSIBLE BY SWITCHING TO ON-LINE PURCHASING. FINANCE UNDER SECRETARY TANZI TOLD US ON SEPTEMBER 30 THAT A E35 BILLION DISCRETIONARY FUND FOR THE NON-BINDING PURCHASE OF CAPITAL GOODS AND SERVICES, SUCH AS TELECOMMUNICATIONS UPGRADES, WOULD BE CUT. PUBLIC SECTOR HIRING WILL BE FROZEN. NOT SURPRISINGLY, MINISTERS ALREADY ARE JOCKEYING TO ENSURE THAT THEIR MINISTRIES TAKE LESS OF A HIT,
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AND THAT FAVORED PROGRAMS ARE PRESERVED AND REMAIN UNDER THEIR CONTROL. IN THE DAYS BEFORE THE CABINET DEBATE ON THE BUDGET, MINISTER OF PRODUCTIVE ACTIVITIES (MPA) MARZANO THREATENED TO RESIGN IF HIS MINISTRY DID NOT RETAIN CONTROL OVER A SPECIAL FUND FOR THE MEZZOGIORNO, ITALY'S SOUTHERN REGION. NEVERTHELESS, UNDER THE 2003 BUDGET, CONTROL OF THIS FUND, INTENDED TO PROMOTE INDUSTRIAL DEVELOPMENT IN THE SOUTH, WILL BE GIVEN TO THE FINANCE MINISTRY, NOT THE MPA. (COMMENT: MARZANO DID NOT RESIGN BUT TOLD US CANDIDLY THAT FUNDING FOR THE MEZZOGIORNO WILL FALL SHORT OF WHAT HE WANTED TO SEE. END COMMENT.)

110. (SBU) THE DRAFT BUDGET PROPOSES LOWER DEFENSE SPENDING IN REAL TERMS. DESPITE A MODEST 0.3 PERCENT NOMINAL INCREASE IN DEFENSE

SPENDING, FROM E19.5 BILLION TO E19.6 BILLION, PREDICTED 2003 INFLATION OF 1.9 PERCENT WOULD MEAN A CUT OF ALMOST 1.6 PERCENT IN REAL SPENDING. THE BUDGET FOR "PERSONNEL, OPERATIONS AND CAPITAL", FOR THE ARMY, NAVY AND AIR FORCE, IS TO BE CUT BY AN ESTIMATED 1.4 PERCENT. DEFENSE MINISTRY CONTACTS ARE CONCERNED THAT PERSONNEL COSTS WILL EAT UP A LARGE PART OF THE BUDGET, AS THE MILITARY MOVES FROM A CONSCRIPT FORCE TO A PROFESSIONAL AND MORE HIGHLY-PAID FORCE. DESPITE THE COMPETING DEMANDS, FINANCE UNDER SECRETARY TANZI TOLD US THAT DEFENSE PROCUREMENT WITH THE U.S. SHOULD NOT BE HARMED. NOTE: ITALY HAS SIGNED ON FOR A USD ONE BILLION INVESTMENT IN THE JOINT STRIKE FIGHTER, AND HAS COMMITTED TO SEVERAL OTHER MAJOR PROCUREMENTS FROM THE U.S. END NOTE.

11. (C) DESPITE TANZI'S REMARKS, WE HAVE HEARD RAMPANT
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SPECULATION THAT DEFENSE PROCUREMENT IN FACT WILL BE AFFECTED. ACCORDING TO ITALY'S LEADING DAILY, IL CORRIERE DELLA SERA, THERE WAS A HEATED EXCHANGE BETWEEN DEFENSE MINISTER MARTINO AND PM BERLUSCONI DURING THE CABINET DEBATE ON THE BUDGET. SPECIFICALLY REFERRING TO ITALY'S STANDING ORDER OF 121 EUROFIGHTER AIRCRAFT AT AN ESTIMATED COST OF E719 MILLION, MARTINO REPORTEDLY TOLD THE PM THAT "DEFENSE TODAY MEASURES THE INTERNATIONAL CREDIBILITY OF OUR COUNTRY. NATO IS CALLING FOR INCREASING INVOLVEMENT AND COMMITMENT. EUROPE IS PRESSING FOR THE CREATION OF A TASK FORCE. YOU AND I WILL HAVE TO MEET AND FACE OUR ALLIES AT THE PRAGUE NATO SUMMIT." MARTINO HAS PUBLICLY STATED THAT ITALY WILL FULFILL ITS COMMITMENT TO BUY THE EUROFIGHTERS, AT THE COST OF ALMOST ONE-QUARTER OF ITS DEFENSE BUDGET OVER THE NEXT TEN YEARS.

-- (C) COMMENT: DEFENSE PROCUREMENT IS FUNDED THROUGH MULTIPLE APPROPRIATIONS, INCLUDING THOSE FOR THE MINISTRY OF PRODUCTIVE ACTIVITIES. DEFMIN MARTINO IS IN FACT TRYING TO SHIFT SOME OF THE EUROFIGHTER COST TO THE MPA, WHICH DOES NOT WISH TO FUND THE PROGRAM. THE 2003 BUDGET BELT-TIGHTENING WILL LIKELY SLOW ITALY'S PROGRESS TOWARD THE EU DEFENSE SPENDING BENCHMARK OF TWO PERCENT OF GDP. OTHER REFORMS WILL, HOWEVER, REMAIN ON TRACK. FRANCESCO TRUPIANO, DIPLOMATIC

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	ITC-01	L-00	VCE-00	AC-01	NSAE-00	OMB-01	OPIC-01
	PA-00	PM-00	PRS-00	ACE-00	P-00	SCT-00	SP-00
	IRM-00	SSO-00	STR-00	USIE-00	PMB-00	DSCC-00	PRM-00
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P 170728Z OCT 02
FM AMEMBASSY ROME
TO SECSTATE WASHDC PRIORITY 6350
INFO EU MEMBER STATES COLLECTIVE PRIORITY
NATO EU COLLECTIVE PRIORITY
AMCONSUL FLORENCE PRIORITY
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ADVISOR TO THE MINISTER OF DEFENSE, TOLD US THAT REDUCED MOD FUNDING WILL NOT SLOW MINISTER MARTINO'S MOVE TOWARD AN ALL-VOLUNTEER MILITARY. END COMMENT.

12. (SBU) THE UNIONS: THE THREE MAJOR TRADE UNION CONFEDERATIONS (CGIL, CISL, AND UIL) SET ASIDE THEIR SUMMER DIFFERENCES (OVER THE GOVERNMENT'S INTRODUCTION OF MODEST LABOR FLEXIBILITY IN ANNUAL LABOR AGREEMENTS) TO SLAM THE DRAFT BUDGET. FOR LABOR, THE BUDGET'S PRIORITIES ARE INVERTED. CAPS ON SPENDING FOR LOCAL SERVICES - WHETHER PUBLIC CHILD-CARE, HEALTH CARE OR EDUCATION -- WILL MORE THAN OFFSET ANY BENEFITS ORDINARY WORKERS WOULD GLEAN FROM A TAX

CUT, UNIONS LEADERS ARGUE. IN THEIR EYES, THE REVENUE-GENERATING TAX AMNESTY IS ONLY THE LATEST EXAMPLE OF A FLAWED ECONOMIC POLICY, WHICH EMPHASIZES ACCOUNTING GIMMICKS AND COZY BENEFITS FOR THE GOVERNMENT'S BUSINESS CONSTITUENCY OVER LONG-TERM INVESTMENT IN RESEARCH, INFRASTRUCTURE AND OTHER MEASURES TO DIVERSIFY ITALY'S ECONOMY. CGIL, THE LARGEST OF THE THREE CONFEDERATIONS, DECLARED THAT ITS OCTOBER 18 NATIONWIDE GENERAL STRIKE WILL BE A PROTEST AGAINST THE DRAFT BUDGET AS WELL AS THE LABOR MARKET FLEXIBILITY PROVISIONS PROPOSED BY CISL AND UIL. (COMMENT: THIS DECLARATION IS A BIT DISINGENUOUS, GIVEN THAT THE OCTOBER 18 STRIKE WAS ANNOUNCED LAST SUMMER, BEFORE THE BUDGET WAS DRAFTED, BUT IS GOOD POLITICS. END COMMENT.) THE LEADERS OF THE OTHER TWO CONFEDERATIONS, BEYOND ECHOING WARNINGS ABOUT WEAK SUPPORT FOR THE SOUTH, WARNED THAT THEY WOULD JOIN CGIL IN THE STREETS IF LOWER-THAN-PROJECTED

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REVENUE PROMPTED THE GOVERNMENT TO CONSIDER REVISING THE TERMS OF THE NATIONAL LABOR PACTS NEGOTIATED IN THE SUMMER.

13. (SBU) INDUSTRY: ANTONIO D'AMATO, CHAIRMAN OF CONFINDUSTRIA, ITALY'S INDUSTRIALIST ASSOCIATION, BLASTED THE BUDGET AS "ONE OF THE WORST LAWS I CAN EVER REMEMBER BEING WRITTEN." HE HAS HARSHLY CRITICIZED THE GOVERNMENT FOR NOT TAKING MEASURES TO INCREASE THE COMPETITIVENESS OF THE ITALIAN ECONOMY, FOR NOT ADOPTING MEASURES TO INCREASE INVESTMENT IN THE MEZZOGIORNO, AND FOR NOT MAKING FURTHER CUTS OR REFORMS IN EDUCATION SPENDING. (COMMENT: D'AMATO HAS BEEN A STRONG PUBLIC SUPPORTER OF THE BERLUSCONI GOVERNMENT. THIS IS THE FIRST TIME HE HAS OPENLY CRITICIZED THE GOVERNMENT, ALTHOUGH HE HAS LONG COMPLAINED PRIVATELY THAT PROMISED TAX CUTS WERE TOO LONG IN COMING. MOREOVER, HE TARGETED HIS CRITICISMS NOT AT BERLUSCONI PERSONALLY, BUT AT TWO COALITION PARTIES: ALLIANZA NAZIONALE AND LEGA NORD, BLAMING THEM FOR THE TIMIDITY AND LACK OF CREATIVITY IN THE BUDGET. END COMMENT.)

14. (C) THE MEZZOGIORNO: FOR MANY CRITICS, CUTBACKS IN SPENDING FOR THE ITALY'S UNDERDEVELOPED MEZZOGIORNO HAVE BECOME THE LIGHTENING ROD FOR CRITICISM OF THE BUDGET. EVEN ITALIAN PRESIDENT CARLO AZEGLIO CIAMPI, WHO GENERALLY STAYS ABOVE SUCH POLITICAL FRAY, HAS REMARKED THAT THE BUDGET DOES LITTLE TO ADDRESS THE INEQUALITY BETWEEN NORTH AND SOUTH, AND THE UNEMPLOYMENT LEVELS OF 20 PERCENT IN THE MEZZOGIORNO. COMMENT: DESPITE THE GENUINE CONCERN ABOUT THE MEZZOGIORNO'S CHRONIC UNEMPLOYMENT, CRITICISM OF BUDGET CUTBACKS FOR THE REGION SEEMS DISPROPORTIONATELY WIDESPREAD. BY FOCUSING ON THE MEZZOGIORNO CUTBACKS, D'AMATO AND OTHER FORZA ITALIA

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SUPPORTERS CAN GAIN POLITICAL CAPITAL WITHOUT TACKLING THE ECONOMIC POLICY OF THE BERLUSCONI GOVERNMENT HEAD ON. END COMMENT. MEETING WITH US ON OCTOBER 9, DEPUTY FINANCE MINISTER BALDASSARI REJECTED ALLEGATIONS ABOUT BUDGET CUTBACKS FOR THE MEZZOGIORNO. HE ARGUED THAT BETWEEN THE CENTRAL GOVERNMENT'S CONTRIBUTIONS, THROUGH DIRECT TRANSFERS, GRANTS AND LONG-TERM LOANS, AND EU FUNDS, THE MEZZOGIORNO WILL RECEIVE A RECORD E9 BILLION THIS YEAR. BALDASSARI ALSO STRESSED THAT THE FUNDING LEVEL IS LESS IMPORTANT THAN THE MEZZOGIORNO'S CAPACITY TO ABSORB THAT MONEY. ON AVERAGE, THE MEZZOGIORNO ONLY HAS BEEN ABLE TO ABSORB A THIRD OF THE EU MONIES EARMARKED FOR IT, HE SAID.

15. (SBU) THE REGIONS: THE BERLUSCONI GOVERNMENT CAME INTO OFFICE IN JUNE 2001 PROMISING TO DEVOLVE MORE AUTHORITY TO THE REGIONAL GOVERNMENTS. DESPITE THIS, BERLUSCONI AND TREMONTI WANT TO KEEP A TIGHT-REIN ON THE FINANCES OF OFTEN SPENDTHRIFT REGIONAL GOVERNMENTS. IN THE 2003 BUDGET, THE GOI PROPOSED AUTOMATIC TRIGGERS THAT WILL FREEZE SPENDING AND HIRING BY REGIONAL GOVERNMENTS IF THEIR SPENDING 2001 LEVELS EXCEEDS BY THREE PERCENT. LOCAL GOVERNMENTS ALSO ARE BEING ASKED TO FOLLOW MORE VIGOROUSLY THE GUIDELINES OF THE EU STABILITY PACT. REGIONAL GOVERNMENTS ARE COMPLAINING THAT THE QUALITY

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P 170728Z OCT 02
FM AMEMBASSY ROME

TO SECSTATE WASHDC PRIORITY 6351
INFO EU MEMBER STATES COLLECTIVE PRIORITY
NATO EU COLLECTIVE PRIORITY
AMCONSUL FLORENCE PRIORITY
AMCONSUL FRANKFURT PRIORITY
AMCONSUL MILAN PRIORITY
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AND DISTRIBUTION OF SERVICES COULD BE AFFECTED, AND HAVE
THREATENED TO RAISE TARIFFS ON TRANSPORTATION AND OTHER
SERVICES TO RAISE REVENUE. COMMENT: FURTHER INCREASES IN
TARIFFS OF TRANSPORTATION AND OTHER PUBLIC SERVICES COULD
RAISE THE IRE OF VOTERS, WHO ALREADY ARE COMPLAINING ABOUT
PRICE INCREASES FOLLOWING THE EURO CONVERSION. HOW REGIONAL
GOVERNMENTS WILL ALLOCATE THEIR FUNDS IS STILL NOT CERTAIN.
END COMMENT.

NOT TOUGH ENOUGH

16. (SBU) IN CONTRAST TO THE MANY VOICES RALLYING FOR HIGHER
SPENDING FOR PET PRIORITIES, THE 2003 DRAFT BUDGET ALSO HAS
BEEN CRITICIZED FOR NOT ENACTING STRUCTURAL REFORMS AND
CUTTING SPENDING DEEPLY ENOUGH. LEADING THIS CHARGE IS
CENTRAL BANK GOVERNOR ANTONIO FAZIO,
WHO HAS WARNED THE GOVERNMENT THAT IT NEEDS TO BRING DOWN
PUBLIC DEBT LEVELS FROM THE EXPECTED NEAR RECORD HIGH OF 110
PERCENT OF GDP THIS YEAR. FAZIO HAS MADE A PUBLIC APPEAL FOR
GOVERNMENT AND PARLIAMENTARY LEADERS TO MODIFY THE DRAFT
BUDGET TO REDUCE SPENDING MORE AND TO INITIATE NEEDED
STRUCTURAL REFORMS. JUMPING ON THE MEZZOGIORNO BANDWAGON, AND
PARTIALLY UNDERCUTTING HIS OWN ARGUMENT FOR DEEPER SPENDING
CUTS, FAZIO ALSO SUGGESTED A NEED FOR GREATER
GOVERNMENT-FUNDED.

COMMENT: GLOBAL ENVIRONMENT IS KEY

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17. (SBU) AS THE GOVERNMENT'S DRAFT BUDGET IS DEBATED IN
PARLIAMENT BETWEEN NOW AND THE END OF THE YEAR, IT IS CLEAR
THAT THE LOSING GROUPS ARE NOT GOING TO ACCEPT THE BUDGET
WITHOUT A FIGHT. INDEED, AN UNLIKELY ALLIANCE BETWEEN
BUSINESS LEADERS AND THE UNIONS (AT LOGGERHEADS JUST A FEW
MONTHS AGO OVER ARTICLE 18 OF THE LABOR CODE) CENTER-LEFT
PARLIAMENTARY LEADERS, AND EVEN SOME CABINET MINISTERS ARE
PRESSING FOR SIGNIFICANT CHANGES. PRODUCTIVE ACTIVITIES
MINISTER MARZANO TOLD A GROUP OF YOUNG ENTREPRENEURS ON
OCTOBER 6 THAT HE WOULD "SIT AT A TABLE WITH" THEM TO DISCUSS
POSSIBLE CHANGES TO THE BUDGET. MOD DIPLOMATIC ADVISOR
TRUPIANO TOLD US THAT THE FIGHT FOR THE MOD BUDGET "ISN'T
OVER".

18. (SBU) THE FINANCE MINISTER HAS CREATED A BUDGET INTENDED
TO STIMULATE GROWTH, WHILE NOT INCREASING THE BUDGET DEFICIT.
HE HAS LABORED TO STRIKE A PROPER POLICY BALANCE BETWEEN TAX
CUTS AND SPENDING CUTS, ONE-OFF MEASURES AND LONG TERM
INVESTMENT PLANS. A BUDGET THAT PLEASES NO ONE MAY, INDEED,
BE THE RIGHT PRESCRIPTION.

19. (C) THE 2003 BUDGET IS, HOWEVER, SOMETHING OF A HIGH-RISK
GAMBLE. IF THE GLOBAL ECONOMY RECOVERS IN 2003, THIS POLICY
MIX MIGHT BE ENOUGH TO REVIVE ITALY'S ECONOMY. THE GOI ALSO
WOULD BE WELL-POSITIONED TO MEET STABILITY PACT TARGETS FOR A
BALANCED BUDGET IN 2006. SHOULD ECONOMIC GROWTH IN 2003 PICK
UP, THE GOI ALSO WOULD BE IN POSITION TO TACKLE THE MORE
INTRACTABLE, STRUCTURAL PROBLEMS, SUCH AS LABOR MARKET
INFLEXIBILITY AND A BURDENSOME PENSION SYSTEM, SHOULD IT
SUMMON THE POLITICAL WILL TO DO SO.

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20. (C) HOWEVER, IF THE GLOBAL ECONOMY DOES NOT REVIVE IN
2003, THEN THE GOVERNMENT COULD BE IN A MUCH-WEAKENED
POSITION FOR THE FUTURE.
DEPUTY FINANCE MINISTER BALDASSARI ACKNOWLEDGED THAT THERE
ARE SOME GREAT UNKNOWNNS, INCLUDING THE EFFECTS OF A POSSIBLE

FIAT COLLAPSE AND THE COST OF THE GENERAL STRIKES. (NOTE: ACCORDING TO BALDASSARI, THE FIAT CORPORATE EMPIRE, ALONG WITH THE BUSINESSES THAT DEPEND ON IT, ACCOUNT FOR FOUR PERCENT OF ITALY'S GDP. BALDASSARI ALSO CLAIMED THAT ITALY LOST NEARLY ONE-HALF OF A PERCENTAGE POINT IN GDP GROWTH BECAUSE OF GENERAL STRIKES THIS YEAR. END NOTE.) THE 2003 BUDGET HAS ANGERED MANY OF THE GOVERNMENT'S MOST STALWART SUPPORTERS, WHILE THE PROPOSED TAX CUTS TO LOW-INCOME GROUPS HAVE LIMITED POLITICAL PAYOFF. IF THE GOVERNMENT IS FORCED TO ENACT EVEN DEEPER SPENDING CUTS DURING 2003, IT WILL FIND FEW SUPPORTERS. THIS WOULD ENDANGER THE GOVERNMENT'S MANDATE TO PURSUE CRUCIAL STRUCTURAL REFORMS, SUCH AS PENSION AND LABOR-MARKET REFORM.

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